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An Analysis of Insider Trading Regulations: A Comparative Study of India, USA & U.K.

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ABSTRACT

The impact of the regulatory bodies on offences related to insider trading is an aspect that requires much research and analysis. The legal framework, though different in the global scenario, has the same objective. The present article is an attempt to study the regulations of insider trading in three different countries. With the time and growth in the securities market, the actual reality of the insider trading has come. This kind of work destroys the trust of the investors like in a country like India who wants the foreign investors to invest with them are not able to get successful as they are new in this game. Various kinds of steps have been taken by the Parliament of India and the Securities and Exchange Board of India, but their actions taken regarding insider trading are almost equal to zero. USA has a very effective regulatory body named as SEC which has made a lot of impact in the securities market of the USA as it has punished a lot of criminals. UK on the other hand is also trying its best to catch USA and is doing a lot better than India. On the other hand, the regulatory body that India have is SEBI which is not able to get much amount of success. SEBI has given up a vast number of powers with it in the stock market but if we see the cases taken by it does not provide us with a good image. It clearly shows that our regulatory body requires a lot of amendments and implementation to make our security market healthy and fair in the eyes of the investors so that we can attract foreign investors towards us.

***Keywords**: Insider trading, Insider, Securities Market, SEBI, Stock, Unpublished price sensitive information.*

I. INTRODUCTION

Insider Trading is uncontrolled in the securities market and is one of the hottest topics for debates. It is a kind of practice which damages the relationship between the investors and the companies. In simple terms a person is said to have committed insider trading when the person is the insider or is a part of management of the company who have all the access related to price sensitive information about the stock market, and hence influences any person to buy or sell his of the company.

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There are many debates regarding insider trading as some people say that this should be legal and not punishable as this may help in building the efficiency of the stock market, but this kind of view is not liked by the authorities of many countries. This act is prohibited as it destroys the confidence of the investors as they may know that the insiders are using confidential information for securing their guaranteed profits. USA and UK are like the professionals in this game have strict laws and various regulatory bodies to control these kinds of offences but a country like India who is a newbie in this game is at a starting stage of building their stock market needs to do a lot more changes in their laws to make their name internationally. Before learning about laws regarding insider trading one must know about the term 'insider'. According to SEBI Regulations 2015, "any person who is- a connected person; or in possession of or having access to unpublished price sensitive information."

"Price sensitive information means any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of company.". If any insider is dealing with the shares of a company knowing all the price sensitive information will be regarded as the offender of the process called insider trading. The Indian government has taken various legislations for the prohibitions of insider trading, but these amendments are not much capable. If anyone have the overview of all the provisions regarding insider trading, then everyone will think that these laws are very strict, and India is also not much behind USA and UK but there is a harsh reality that the regulations of these provisions are terrible.

Studying the laws on securities in the U.S.A and the U.K can help see where India's laws may need improvement. India often looks to adopt and adapt laws from other countries. Comparing these laws can show where India's rules for the stock market might not be enough.

II. Historical background

(A) India

The Indian government took the first step for making the provisions regarding Insider trading was in May 1984. The Patel Committee was established to improve the working of the stock market and to make any kind of modifications and implementations to the legislation. Suggestions were given by the committee to prohibit the process of Insider Trading in the market. Later, another committee was established which was named as Abid Hussain Committee in 1989, which said that insider trading should come under both civil and criminal offence. This committee also suggested SEBI make some regulation for the prevention of these types of deals as it may affect the market. After the SEBI, 1992 the functioning of security market came under the control of SEBI.

The basis on which the board exercises its power is given in Chapter 4 of the SEBI Act, 1992. The duty of the board is to protect the interests of investors is given under section 11 of the SEBI,1992. The board has the power to make regulations under section 30 of the act. In enactment of this the board made the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015. At current the offence of insider trading in India is regulated by the SEBI Act, 1992 and the SEBI (PIT) Regulations, 2015.

So, insider trading is regarded as criminal offence, and both imprisonments fine can be imposed to the liable person who is found guilty under this offence. There is a penalty for dealing under the unpublished price sensitive information or providing this information to the any other person who will make a deal under this is given under section 15G of this act. The person who will be guilty of this offence would be given with a penalty of 25 Crores or three times the profit incurred while doing this offence. Whichever is more will be paid by the liable person. This kind of punishment will only be liable if it will be clearly proved that the person was an insider and has also done any kind of deal out of which he has incurred huge amount of profit from it. The directors and the managing officers of the company are also prohibited in getting engaged in insider trading process.

The PIT Regulation said this offence as punishable with an imprisonment up to 10 years or of fine up to 25 crores or both. Regulation 3 and 4 of the SEBI Regulations, 2015 provides with the provisions by which the insider trading is penalised in India. These regulations do not make it clear that whether the motive here is important to make a person liable of the offence. For example, In the UK, if someone is accused of insider trading but didn't have a clear reason for doing it, they can use that as a defence. However, this idea isn't specifically mentioned in the insider trading regulations.

One of the popular cases of Insider Trading in India is of Indian bulls. The person named as Pia Johnson and Mehul Johnson were held guilty for committing the offence of insider trading. Pia and Mehul both made profit of Rs69 Lakhs with the help of unpublished information which Pia by virtue of his post and Mehul being the husband was expected to be aware of that price sensitive information. “SEBI ordered to impound rupees 87.21 lakh jointly and severally from Pia and Mehul and directed banks and depositories that no debits shall be made, without permission of the regulator”.

(B) USA

United States of America is regarded as one of the countries with the best set of laws regarding insider trading and the security market. During the time of Wall Street Crash, the legislation for the development of the federal securities laws was required and was made the congress because there was great fall at that time. At that time the companies were trying their best to promote the investors to attract the people to buy their shares. The brokers were gaining huge number of profits at that time as they continuously selling their stocks to the investors by which this ended up with the mass sale of the stocks by the investors which directly resulted in 1929 Crash of Wall Street.

After this, The Securities Act, 1933 recognised insider trading as the fraudulent practices, later the Securities and Exchange Act, 1934 gave more provisions for the prevention of insider trading. Provisions regarding insider trading was made by the state and the federal laws both. According to misappropriation theory and classical theory USA said that insider trading would be regarded as the criminal offence. The misappropriation theory gives the liability to an outsider who is not in the management but is indirectly connected to the person who have access to the unpublished price sensitive information. And on the other hand, the classical theory gives liability to the person who has access to the unpublished price sensitive information directly and he trades it to earn profit, this person will be liable as he is breaking the loyalty and the fiduciary relationship with the company.

The punishment for the person liable under this offence will be given of 20 years of imprisonment in a federal prison and a fine of $5,000,000 for the natural person. If the same offence is committed by the company, then the fine may extend to $25,000,000. In addition to facing criminal charges, someone might receive a civil penalty, like a fine three times the amount they gained or lost using secret information. If they're a professional, they could be prohibited from trading shares, or they might lose their job position in the company.

One of the well-known cases of insider trading in the United States of America is of Rajat Gupta and Rajaratnam. Ther person named as Rajaratnam started his career in Manhattan Bank as a landing officer. Galleon which was a hedge fund management fund was started by him only. Soon, on 16 October 2009 Rajaratnam was arrested under the offence of insider trading. The other person named as Rajat Gupta was a director in Goldman Sachs. Rajat Gupta provided multiple tips to Rajaratnam in support of him. He shared information about Berkshire's forthcoming investment in Goldman Sachs and disclosed undisclosed financial details to Rajaratnam. Many records were found which revealed that Rajaratnam was having many connections in various companies. The total amount of profit which he made by this act was of around $18.5 million. He was liable under this offence and was punished with a fine of $10 million. He has also been punished with the imprisonment for 11 years and the other person named as Rajat Gupta has been punished with the imprisonment of 2 years.

All these things directly justify that USA at the top for executing their laws and then enfranchising it to the offenders.

(C) UNITED KINGDOM

In United Kingdom, The Criminal Justice Act, 1993 insider trading is regarded as the criminal offence. The provisions used by the UK was given by under the direction of the European Union for the topic Insider Trading. Section 52 of the Criminal Justice Act, 1993 gives their different types of offences which can be committed by a person in United Kingdom. A person who deals with the unpublished price sensitive information, a person who encourages any other person to deal in market and a person who discloses such kind of information to other people. All there three situations a will be regarded as criminal offence of insider trading in United Kingdom as these three are given under the legal provisions of the country. In UK the leak of the unpublished price sensitive information is a material fact and can also be used as defence in prosecution. Section 61of the act provides us with the punishment of insider trading which is imprisonment of 6 months which will not be exceeding 7 years or fine or both may be awarded. The provisions regarding the prevention of the market abuse which is considered as civil offence is given under the Financial Services and Markets Act, 2000. The regulatory body of UK is the Financial Service Authority which is given with the powers to sanction any person busy in these kinds of activities.

III. Legal provisions in India, USA & UK

The Securities and Exchange Act of 1934, Section 4, established the Securities and Exchange Commission (SEC) to oversee the operations of stock exchanges in the United States. Similarly, in India, the SEBI was formed in 1988 and granted legal authority through the SEBI Act of 1992, serving as the Indian equivalent of the SEC to regulate stock exchanges.

When comparing both the regulatory bodies, The Securities Exchange Commission, and the SEBI anyone can easily witness the loophole which the Indian part of the Security Exchange Commission has. For example, on average, the SEC assigns one employee per listed firm, while SEBI's employees are responsible for monitoring and examining the operations of approximately six listed firms each. The Financial Services Authority in the United Kingdom is also at the same position as the SEBI in India.

To effectively monitor illicit activities in the stock market, regulatory body employees need the ability to verify the accuracy of firms' financial statements. With approximately 4,554 employees, the SEC contrasts sharply with SEBI's staff of only 780 individuals. This lack of personnel at SEBI leads to an overburdening of its employees, consequently impacting their efficiency.

According to the annual report of 2016-17, the investigations for insider trading was taken by SEBI and there were 34 cases out of which only 15 were completed by the SEBI. So, SEBI requires more and more well qualified employees in their organizations and the board should be given up with more powers to carry out the functions. The new employees who are going to soon join the organization must have all the necessary qualifications and vast amount of knowledge about the field and work in the organization.

The major reason why the criminals in India gets easily escaped without being prosecuted is that they would be having any kind of strong political background by which no one can take much action against them not even the government. There are provisions regarding the institutional mechanism for keeping an eye on these kinds of activities and it is given under the SEBI (PIT) Regulations, 2015. Many cases are usually settled outside without coming into court, this shows us that the provisions regarding insider trading are just for the purpose of showoff only. The SEC has significant authority to dismiss prominent figures in the stock market who engage in insider trading.

The rate of insiders using unpublished information for their benefit could be decreased if the companies themselves make frequent disclosures rather than doing it on monthly or quarterly basis. Another approach to mitigate the frequency of such offenses is to disclose information regarding share trading by corporations. By this the gap can be filled between the people who have access to price sensitive information and the people who don’t. It is very important to make the market transparent and to decrease the rate of getting price sensitive information to the people who are ready to make huge number of profits through this process. Increasingly, social media platforms like Facebook and Instagram are being utilized to decrease the likelihood of establishing connections between the Tipper and the Tippee. According to a regulatory official, the offenders are becoming very advanced, and they are one step ahead of the government who are trying to catch them. The criminals are becoming very smart, so the regulator is advised to find some new methods to bring them back. SEBI has opted to monitor social media to establish connections between offenders, a task that is challenging through traditional methods like KYC documents and bank account details.

IV. CONCLUSION

The core issue is that insider trading acts like a parasite, draining income from the global market and undermining the fundamental principles of its existence. The main concern of insider trading is that it damages and harms the confidence of the people or the investors as it is a kind of cheating which the insiders are doing. SEBI should be given more powers and should also become free from the interference of the politicians who gets involved in this activity. Effective surveillance methods should be adopted to keep an eye on the working of the stock market. Only by properly enforcing and implementing laws can we effectively address this issue. In lord lane's view, the rationale behind the prohibition on insider trading is "the obvious and understandable concern about the damage to public confidence which insider dealing is likely to cause and the clear intention to prevent so far as possible what amounts to cheating".

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